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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967.

No. 240.

ARKWRIGHT MUTUAL INSURANCE COMPANY,
Petitioner,

v.

BARGAIN CITY, U. S. A., INC.,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

RESPONDENT'S BRIEF CONTRA PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Respondent, Bargain City U. S. A. Inc. by its counsel Mesirov, Gelman, Jaffe and Levin respectfully replies to the petition for writ of certiorari filed herein and respectfully requests that said petition be denied.

COUNTER-STATEMENT OF QUESTION INVOLVED.

Should a petition for writ of certiorari be granted on the following question answered in the negative by the courts below:

Does a debtor's promise to assign a share of its future recovery of damages from the United States for tortious injury to the debtor's property, if the creditor shall request such assignment, create an equitable lien on that recovery which survives the debtor's discharge following proceedings under Chapter XI of the Bankruptcy Act, which proceedings intervened between the date of the promise and the actual recovery, where the creditor never requests the assignment prior to the approval of the plan of arrangement, although the creditor has notice of said proceedings, is listed as a general creditor in the debtor's schedules, and attends the meetings without formally appearing or filing a claim, and the debtor's claim against the United States is listed as an asset in the arrangement proceedings?

COUNTER-STATEMENT OF CASE.

On cross-motions for summary judgment seeking $100,000.00 deposited in the Registry of the Court, the United States District Court for the Eastern District of Pennsylvania by the Honorable C. William Kraft awarded respondent (hereinafter called "defendant") the fund together with interest. The facts giving rise to the cross-claims are as follows:

On August 27, 1961 a Navy jet crashed into defendant's store in Horsham, Pennsylvania, causing damages in excess of $100,000.00. Defendant was covered by insurance from the petitioner (hereinafter called "plaintiff") for this type of damage, but defendant, with plaintiff's knowledge, made claim directly to the Government, and the insurance policy claim was held in abeyance.

In March, 1962, while the Government claim was still pending, defendant requested and obtained from plaintiff a loan of $100,000.00. In connection with that loan, plaintiff prepared, and defendant executed, two documents, each dated March 23, 1962, entitled "Receipt and Agreement" (hereafter called "Agreement") (69a-72a) [1] and "Loan Receipt" (hereafter called "Receipt") (74a). Defendant thereafter (March 26, 1962) received plaintiff's check for $100,000.00 (73a). At no time since has the plaintiff perfected any security interest in or to the Government claim, or to the proceeds that were ultimately paid against that claim. (Defendant's Answer and Affidavit Against Motion for Judgment) (31a, 126a).

On October 18, 1962, defendant filed a Petition for Arrangement under Chapter XI of the Bankruptcy Act (Civil Action 27505) and scheduled among its assets the crash claim against the Government, which was then still unliquidated (36a-42a). Defendant also scheduled the

1. All references, except where otherwise stated, are to the printed record as filed in the Court of Appeals for the Third Circuit.

plaintiff's loan of $100,000.00 as an unsecured debt in the schedules listing general creditors (42a). Plaintiff received written and actual notice of the Arrangement proceedings (126a-130a). Attorneys representing plaintiff attended hearings in those proceedings, but did not enter any Appearance of record (126a-130a). At no time did plaintiff file (or attempt to file) a claim, preferred or otherwise, or Reclamation Petition, or other action in the Chapter XI proceedings. Plaintiff knew of the proposed plan of arrangement and the impending entry of the Order of Confirmation, which called for payment of unsecured debts in full, upon payment of 15% of the amount of each debt in 48 equal monthly installments (126a-130a). Following confirmation of the plan, defendant tendered the installment payments to the plaintiff, which refused the same (126a-130a). The Arrangement proceedings terminated on or about March 20, 1963.

Shortly after the termination of the Arrangement proceedings (March, 1963) the Department of the Navy completed its review of defendant's claim and suggested payment of the same in the amount of $228,404.34 of which $156,000.00 represented adjustment for the loss of rental. On or around May 17, 1963, Congress enacted a Supplemental Appropriations Act to permit payment of the adjusted claim, and, under date of June 4, 1963, the Government check was issued in payment of the claim.

The basic document involved herein is the Agreement (69a-72a) which provides inter alia:

> "... *at Arkwright's request,* Bargain City will execute and deliver such instrument of assignment ... as will permit the United States ... to make payment ... directly to Arkwright." (Emphasis supplied.)
>
> "... in the event of any conflict between the provisions of the said 'Loan Receipt' (73a) and the provisions of this receipt and agreement, this receipt and agreement shall govern."

No request was made for any assignment prior to the Arrangement proceedings. On the contrary, plaintiff waited until all other general creditors had approved the plan of arrangement before plaintiff sought any assignment from defendant (Plaintiff's Request for Admissions No. 28) (50a).

Upon the foregoing circumstances the district court sustained defendant's motion for summary judgment and refused plaintiff's motion. From this decision plaintiff appealed to the Court of Appeals for the Third Circuit which affirmed the decision of the district court.

Plaintiff has now petitioned this Honorable Court for a writ of certiorari to the Court of Appeals.

ARGUMENT.

I. Defendant's Claim to the United States for Damage to Its Property, Including Loss of Rental Income, Became a Part of Defendant's Estate for Administration in the Chapter XI Proceedings.

The powers and jurisdiction of a court in the Chapter XI proceedings are enumerated in 11 U. S. C. § 712.

> "Where not inconsistent with the provisions of the chapter, the jurisdiction, powers, and duties of the court shall be the same—
>
> (1) where a petition is filed under section 721 of this title and a decree of adjudication has not been entered in the pending bankruptcy proceeding, as if a decree of adjudication had been entered in such bankruptcy proceeding at the time the petition under this chapter was filed; or
>
> (2) where a petition is filed under section 722 of this title as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter was filed."

Since there are no inconsistent applicable provisions, the jurisdiction of the court in this case would be identical to that in a bankruptcy case; and that which would pass to a trustee in bankruptcy would properly be treated as subject to the jurisdiction of the court here.

The question herein narrows to whether the claim against the United States is properly subject to the jurisdiction of a bankruptcy court. The Bankruptcy Act clearly vests in the trustee of the estate the title to property such

as a right of action. 11 U. S. C. § 110(a) provides *inter alia:*

> "The trustee of the estate of a bankrupt . . . upon his or their appointment and qualification shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except so far as it is to property which is held to be exempt, to all of the following kinds of property wherever located . . . (5) property, *including rights of action,* which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: . . . (6) *rights of action arising upon . . . injury to his property . . .*" (Emphasis supplied.)

The foregoing provision has been interpreted to include claims against the United States, so long as the claim is not for a pure gratuity.

That is, the cases draw a distinction between claims which arise for redress of recognizable legal wrongs, and those which would not allow recovery if two private individuals were involved. In *Erwin v. United States,* 97 U. S. 392 (1878) the trustee in bankruptcy sold all claims of the bankrupt. Included was a claim against the United States for bales of cotton taken. The court held the trustee had title and could validly sell the claim stating (at pp. 395-396):

> "When the appellant filed his petition in bankruptcy, his claim against the government was property, though of uncertain value. . . . Claims for compensation for the possession, use or appropriation of tangible property constitute personal estate equally with the property out of which they grow, although the validity of such claims may be denied, and their value may depend upon uncertainties of litigation, or

> the doubtful result of an appeal to the legislation. . . . Demands against the government, if based upon considerations which would be valid between individuals, such as services rendered or goods taken, are property, although there be no court to investigate and pass upon their validity, and their recognition and payment may depend upon the caprice or favor of the legislature."

In *Campbell, Assignee v. United States,* 28 Ct. Cl. 512, 513, the court held:

> "Three things concerning the assignment of claims against the Government may be regarded as well settled:
>
> "(1) That such claims as are choses in action upon which a suit can be maintained as a matter of legal right, if there be a jurisdiction, and in which 'there is no element of a donation in the payment ultimately made' . . . pass in bankruptcy and may be prosecuted by the assignee or by the purchaser in bankruptcy proceedings. . . .
>
> "(2) That the title to what is known as abandoned and captured property, not having been divested by capture, a claim for the proceeds in the Treasure is a cause of action which passes in bankruptcy, although no jurisdiction exists at the time in which it can be prosecuted . . .
>
> "(3) That a mere expectancy, a claim founded on no legal right known to courts of law or equity, a claim which is but an appeal to the clemency of Congress for the redress of an injury, where there is no obligation on the part of the Government, and the granting of relief is purely a matter of legislative discretion, cannot be regarded as property and does not pass in bankruptcy . . ."

It is clear that the injury sustained in the present case is of a type which, if a private individual had inflicted it, would be subject to a legal right of recovery. There can be no doubt that if an aircraft of a private company struck the defendant's building, defendant would have had a claim against the aircraft operator.

Consequently, defendant's claim against the United States was such a claim as became subject to the jurisdiction of the court to be administered in the Chapter XI proceedings.

II. Plaintiff Did Not Acquire an Equitable Lien Which Survived Defendant's Arrangement Proceedings That Intervened Between the Making of the Loan by Plaintiff and the Ultimate Recovery of Funds Here in Dispute.

A. There Was No Equitable Lien.

Plaintiff relies upon the language of the Receipt (74a) which states, inter alia,

> ". . . as security for such repayment, we hereby pledge to Arkwright Mutual Insurance Company whatever recovery we may make . . ."

Plaintiff neglects to read this provision in light of the Agreement (69a-72a) which states that defendant *promises to assign* to plaintiff its recovery, *if plaintiff so requests,* and any conflict between the Agreement (69a-72a) and the Receipt (74a) must be governed by the terms of the Agreement (69a-72a).

According to the uncontroverted evidence there is a complete failure to prove that an equitable lien was imposed on the fund. The language of the two applicable documents when construed on the basis of the Agreement being the governing document, establishes that there was no distinct present appropriation of the fund. Without such present appropriation, there could be no lien. A mere promise to

assign, if requested, does not create an equitable lien. See *Jamison Coal & Coke Co. v. Goltra*, 143 F. 2d 889 (8th Cir., 1944), and authorities cited in opinion of Judge Kraft at pages 161a-165a.

Furthermore, plaintiff's main contention based on the use of the word "pledge" in the Receipt (74a) even when the Receipt is not construed with the Agreement (69a-72a) also fails. It has been held that a transaction intended as a pledge, where there is no delivery, cannot create an equitable lien against a trustee in bankruptcy who represents creditors of the "pledgor." See *Fourth Street National Bank v. Millbourne Mills Co.*, 172 Fed. 177 (3rd Cir. 1909), cert. dismissed, 217 U. S. 610 (1910), where the opinion states at pages 178 and 184-185:

> "The question involved in this case is the validity, as against the trustee, of certain pledges or attempted pledges of grain and flour on store at the mills of the bankrupt company. The company issued certificates, after the manner of a warehouse, of the quantity of these commodities on hand, on the strength of which, as collateral, loans were secured from time to time; the property, however, remaining in the possession and under control of the company, and there being nothing outside of the certificates to indicate the rights of the certificate holders to it. . . .
>
> "*It is however, contended that, there being an intent to pledge, an equitable lien was at least created, which entitled the certificate holders to the fund. It is difficult to see how a transaction, which, for want of delivery, is ineffective as a pledge, can be pieced out, so as to make it hold as something else.* There would be little left to the established doctrine with regard to pledges, if that was the case; and it is somewhat singular, that in all the litigation, where pledges of personal property have been upset, for want of a delivery, no one should have discovered this easy way out. This is not to say that an equitable lien, under some cir-

> cumstances, may not exist; but only that there is nothing to support it here. It never arises or is enforced except against property in the hands of a party to the original transaction out of which it is claimed to grow, or his voluntary representatives, or one who has notice of it and is affected with it as a superior right; within which all the cases cited in support of it will be found to fall. . . . *It is not good as against a trustee in bankruptcy, taking title, in the interest of creditors, by operation of law, as is the case here.* (Emphasis supplied.)

The failure to perfect the alleged pledge by delivery is fatal to plaintiff's theory of equitable lien.

But even if plaintiff has some color of right by virtue of an alleged equitable lien, such interest could not survive the defendant's Chapter XI Proceedings in this case.

B. Plaintiff's Alleged Interest in the Fund Recovered by Defendant From the United States Was Extinguished by the Chapter XI Proceedings.

Plaintiff's position appears to be that while plaintiff had no perfected secured interest in defendant's claim against the United States (which was one of the scheduled assets upon which the creditors agreed to the arrangement), plaintiff nevertheless now has an interest in the proceeds of that claim superior to the rights of all creditors and shareholders of the defendant by virtue of an alleged equitable lien which survived the Chapter XI Bankruptcy proceedings.

(1) *Whether or not an equitable assignment or lien can have any legal efficacy depends on state law.*

Remington on Bankruptcy, Sections 1724 and 1725, state, inter alia:

> "Equitable assignments are transfers or attempted transfers of property not evidenced or com-

pleted as required for recognition at law, but which a court of equity will recognize or enforce under the doctrine of regarding that as done which ought to have been done. Since this type of "assignment" rests on the equities of the particular case, the field is broad and we do not purport to exhaust it. The attitude of the courts toward giving effect to such transactions varies from state to state, and local statutes in one state may prevent the recognition of assignments and transfers which the courts of another state, unhampered by such legislation, would hold to be of force. *In bankruptcy, the efficacy, of transactions of this kind entered into by the bankrupt, as against the trustee, depends upon applicable local law.* A bankruptcy court is a court of equity and nothing prevents it from applying equitable principles either to uphold or defeat rights, but it connot create new kinds of property rights out of whole cloth. *It is dealing only with such rights as may exist under applicable state law.*" . . . (Emphasis supplied.)

"Creation of an equitable lien requires no particular formality and the lien may rest in parol in the absence of statute specifically requiring writings. Recording acts, statutes of frauds, and the like, are purely local and vary from state to state, both in phrasing and interpretation. A court of equity cannot, of course, give effect to a transaction falling within the scope of such provisions if the statutes, in terms or by construction, make it void or unenforceable. Furthermore, if the property claimed to be subject to the lien remains in the bankrupt's possession and comes into the hands of his trustee in bankruptcy, that circumstance may, under the law of some states with respect to transactions of the kind in question, place the trustee in a superior position."

(2) *The alleged lien herein was not enforceable under Pennsylvania law.*

The Pennsylvania law (which governs this action) is the Uniform Commercial Code, Act of April 6, 1953, P. S. 3, § 9-101, et seq., as amended, 12A P. S. § 9-101, et seq., which provides, inter alia in 12A P. S. (Pocket Part) § 9-102(1), 106, 301(1, 3) and 302(1)(a):

"... this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this State.

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; ..."

"... 'General intangibles' means any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments."

"Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of:

(b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected;"

"A 'lien creditor' ... includes ... a trustee in bankruptcy from the date of the filing of the petition ..."

"A financing statement must be filed to perfect all security interests except the following:

"(a) a security interest in collateral in possession of the secured party under Section 9-305;"

The foregoing provisions establish that plaintiff did not have an enforceable lien under Pennsylvania law because: (a) Title 9—Secured Transactions—applies to any attempted creation of security interest in personal property and general intangibles (9-102(1)); (b) General intangibles includes things in action (9-106); (c) An unperfected security interest is subordinate to rights of lien creditors including a trustee in bankruptcy (9-301(1, 3)); and, (d) Neither was a financing statement filed, nor possession of the collateral delivered to plaintiff (9-302(1)(a)).

Defendant contends that Section 9-104(k) of the Uniform Commercial Code excludes the filing of "a transfer in whole or part of . . . any claim arising out of tort," so that the alleged transfer of the claim herein could not be perfected by filing. This argument overlooks two major obstacles. First, the claim against the United States was not a tort claim but a claim arising under the Military Claims Act, 19 U. S. C. § 2731 et seq. Claims under that Act are not controlled by the Rules applicable to common law tort claims. Second, under Pennsylvania law which governs the interpretation of the Pennsylvania version of the Uniform Commercial Code, although there could be no assignment of a personal injury action, property damage claims could be assigned. (See *Lemley v. Pizzica,* 36 D. & C. 2d 327 (1964).) As such the filing provisions of the Uniform Act would apply to property damage claims (which are assignable) but not apply to personal injury claims (which are not assignable). The claim herein being a property damage claim, it could be assigned; and to perfect that assignment the filing provisions of the Uniform Commercial Code should have been complied with by plaintiff.

(3). *Only by showing that it held a perfected security at the time of the filing of the petition, could the plaintiff avoid the statutory discharge of its debt claim against defendant.*

Plaintiff has not made any claim herein that it had a perfected security interest under state law; on the contrary, defendant's Affidavit Contra the Motion for Judgment establishes that plaintiff made no attempt to perfect any alleged security interest prior to the arrangement (126a-130a).

Since plaintiff never perfected its claim lien under state law, under § 70(c) of the Bankruptcy Act, 11 U. S. C. § 110(c) [2] defendant's receivers were "vested with title" to defendant's claim against the United States which was "scheduled in arrangement." As such, by virtue of § 70(c) any alleged interests of plaintiff were cut off.

In *In re Martin Custom Made Tires Corporation,* 108 F. 2d 172 (2nd Cir. 1939) the Court held that the debtor in corporate reorganization proceedings who remained in possession of personal property which was covered by an unrecorded chattel mortgage was entitled to have the mortgagee treated as an unsecured creditor; and the entire debt put into the class of general unsecured claims.

The same result has been reached in numerous cases involving intended securities which were not perfected. *In re Luscombe Engineering Co.,* 163 F. Supp. 129 (E. D. Pa. 1957); *In re Fortescue,* 122 F. Supp. 883 (E. D. Pa. 1954); *Markovitz v. Taylor,* 94 F. 2d 782 (3rd Cir. 1938); *In re Plymouth Glass Co.,* 171 F. Supp. 650 (E. D. Mich. 1957).

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2. § 70(c) of the Bankruptcy Act, 11 U. S. C. § 110(c) provides: "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

To hold as plaintiff contends, that equitable liens survive Bankruptcy or Arrangement proceedings would invite evasionary tactics by creditors of insolvents, encourage fraudulent concealments, emasculate the discharge provisions of the Bankruptcy Act, and severely impair the secured transaction title of the Pennsylvania Uniform Commercial Code. Plaintiff has cited no case decided under the applicable Bankruptcy Act and Uniform Commercial Code which supports plaintiff's contention, and defendant's research has produced no such case.[3]

III. The Equities Do Not Justify Plaintiff's Recovery.

It is clear that the plaintiff sought to hedge against several risks in its dealings with the defendant and defendant's creditors. Plaintiff preferred not to pay out moneys to defendant under its policy, which would have given it a right of subrogation. It was satisfied to treat the loan as a debt until after defendant became insolvent. Plaintiff did not wish to test its rights in the Arrangement proceedings. Only after all other unsecured creditors were barred by the arrangement confirmation, did plaintiff institute this suit. Having assumed all of those risks, the plaintiff now asks the Court to minimize its loss by special treatment.

A similar case where the Court refused to recognize an alleged equitable lien was *Jamison Coal and Coke Co. v. Goltra,* 143 F. 2d 889 (8th Cir. 1944). In the *Jamison* case, the debtor, in consideration of a loan of $5,000.00, promised the creditor in the event he successfully prosecuted a claim against the Government and recovered judgment, to apply the proceeds toward the purchase of certain Bonds issued by plaintiff's company. The Court affirmed the dismissal of the plaintiff's Petition, and refused to give

3. As to *Hurley v. Ashbridge,* 55 Pa. Superior Ct. 523 (1914) cited by plaintiff, see Judge Kraft's footnote 1 (164a) distinguishing the facts. Moreover, *Hurley v. Ashbridge* was decided some 40 years before the adoption of the Uniform Commercial Code.

legal efficacy to an alleged equitable lien. It was noted that petitioner's claims were against an insolvent estate and that specific performance would enable the plaintiff to obtain a preference over the other creditors.

Plaintiff herein suggests that denial of its claim will result in unjust enrichment to defendant. This argument completely ignores all of the attendant circumstances of the creation of the debt, the Arrangement proceedings, the defendant's present position, and the host of creditors who remain to be paid under the Arrangement proceedings. The plaintiff having taken a calculated risk in the treatment of its loan and in avoiding the challenge of the other creditors and Referee to plaintiff's claimed status as a secured creditor, cannot realistically complain of "unjust enrichment". Indeed, it is the plaintiff who seeks unjust and preferential treatment by appropriation of available funds of the debtor, to which all other creditors should have equal benefit. The defendant cannot be accused of unjust enrichment in seeking to enforce the debtor relief provisions of the Bankruptcy Act which limit plaintiff's recovery to the terms of the arrangement, and in seeking to deny to the plaintiff any preferential appropriation of defendant's assets, which are required to pay all the creditors.

As the Court of Appeals succinctly stated in its opinion:

> ". . . it was incumbent upon Arkwright, . . . [after] it had notice of the proceedings, to marshal the facts of the transaction and alert the creditors to their professed legal significance by presenting its claim during the course of the proceedings. To hold otherwise would, as in this case, seriously upset the stability and utility of arrangements accomplished under Chapter XI."

CONCLUSION.

For the foregoing reasons as well as for the reason that the petition fails to allege a sufficient basis under Supreme Court Rule 19 to be granted, respondent respectfully requests this Honorable Court to deny the petition for writ of certiorari.

Respectfully submitted,

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Certificate of Service.

It is hereby certified that service of Respondent's Brief was made upon Counsel for Petitioner on the third day of July, 1967 by first class mail.

PAUL L. JAFFE,
for MESIROV, GELMAN, JAFFE & LEVIN,
Attorneys for Respondent.